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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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The Federal Reserve . . .

Within the past three weeks, a flurry of generally upbeat business statistics has heightened speculation that the Federal Reserve is about to put further monetary policy easing initiatives on hold—dimming prospects for further interest rate declines in general, and another cut in the discount rate in particular. But whether such concerns are justified or not appears questionable. For although the economy was estimated to be expanding at a seasonally adjusted 3.1 percent annual rate clip in the second quarter, or well above the anemic 0.3 percent gain posted in the first, and the index of leading economic indicators moved higher in May, the manufacturing sector of the economy remains mired in its own mini-recession.

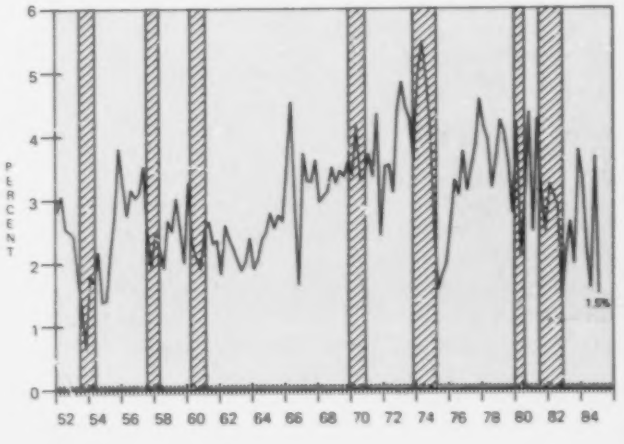
This is because with imports capturing an ever larger chunk of consumer and business spending (Financial Digest—June 24, 1985) industrial production today stands no higher than it did last summer, while manufacturing employment has stagnated. And, with the dollar remaining so strong in the foreign exchange markets, there is little to suggest that this will change anytime soon. As a result, with doubts existing regarding the strength of the business expansion, inflation rate expectations dormant and business credit demands soft, the Fed has little to lose in easing policy further.

While perceptions of the health of the economy may have shifted in recent weeks, it is uncertain whether underlying economic reality has—a question which will be carefully considered at this week's monetary policy-setting Federal Open Market Committee meeting. For although business activity is still expected to rebound over the balance of this year, the surge in imports continues to penetrate evermore deeply into domestic markets and the trade deficit continues to widen. It soared past $12½ billion in May alone—the second highest monthly trade deficit on record—and, needless to say, at this level represents a severe drag on GNP growth in general, and the health of manufacturing in particular. As long as this trend continues, the improvement in the business outlook largely applies to those industries which are immune from import competition.

. . . Still Has Several Good Reasons . . .

While doubts persist regarding the strength of the business expansion, when it comes to the near-term inflation rate outlook, they are few and far between. Although consumer prices expanded at an almost 4½ percent annual rate clip over the past three months, well above the three percent plus pace of the immediately preceding three-month period, this stemmed primarily from an upturn in energy prices—a temporary event which has already begun to reverse itself. Excluding energy, consumer prices rose at a paltry 2.8 percent annual rate over the past three months—significantly lower than the almost five percent rate of rise posted during both the earlier three-month period, and in 1984 as a whole.

NET EXTERNAL FUNDS RAISED BY NONFINANCIAL CORPORATIONS AS A PERCENT OF GNP



While some price pressures may build as the year unfolds, this is certainly not assured. Wage settlements are modest, oil prices are softening, foreign product competition remains keen and today's low inflation rate environment itself limits the ability of domestic manufacturers to raise prices. Indeed, it appears a good bet that inflation rates will remain quite modest, removing a major obstacle to additional central bank accommodation.

The Fed thus finds itself able to concentrate on stimulating business activity, with little worry of

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sparking an acceleration in the rate of inflation—enabling it to generously provide reserves to the banking system, guide the key Federal funds rate lower and, on occasion, trim the discount rate. And, while the growth of the M1 money supply has accelerated—expanding at a double-digit annual rate over the past three months—even this may not present that much of an obstacle to ease. Not only is the growth of the M2 and M3 money numbers still within target, but some of the reasons behind the growth of M1 itself may be suspect. For it is still unclear to what extent the current M1 money supply bulge may reflect the tardy distribution of individual income tax refunds, now showing up in deposit balances, or is a harbinger of brisker levels of business activity and an upturn in inflation pressures.

. . . For Easing Monetary Policy Further

But one thing in all this is clear: trends in business credit demands, so often the swing factor in the interest rate outlook, have encouraged lower, rather than higher interest rates. Over the past 13 weeks, for example, outstanding short-term business credit—which includes bank loans and nonfinancial company commercial paper—expanded by less than $6 billion, far below the more than $16½ billion increase registered during the same 1984 period.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	6/26/85		
U.S. Gov'ts and Agencies Owned Outright & RPs	175.012	+ .657	+11.124
Loans to Depository Inst.	.735	– .692	– 2.238
Float	.314	– .484	– .492
Total Reserve Bank Credit	188.052	– .438	+11.482
Treasury Deposits with Federal Reserve Banks	3.754	+ 1.240	+ .353
Currency in Circulation	185.150	– .497	+11.129
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	121.759	– .642	+ 4.851
	6/19/85		
Member Bank Reserves:			
Total Reserves Held	42.203	+ 1.589	+ 4.015
Excess (Deficiency)	.719	– .087	+ .040
Net Free Reserves	.208	+ .006	+ .520

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (6/17/85)	589.3	+ 11.3‡	+ 7.7‡
M2 (May '85)	2,444.5	+ 3.9	+ 8.4
M3 (May '85)	3,075.2	+ 4.5	+ 9.3
Domestic Nonfinancial Debt (1st Q'85)	6,147.0	+ 11.3	+ 13.6

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/5/85	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	6.81%	6.82%	6.92%
* Federal Agencies	7.02	7.08	7.58
* Municipal Notes—High Grade (46% Taxable Equivalent)	6.94	7.41	7.96
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.35	7.45	7.80

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.40%	Aug.	7.30%
15- 29 days	7.40	Sep.	7.30
30- 59 days	7.40	Oct.	7.30
60- 89 days	7.35	Nov.	7.30
90-179 days	7.30	Dec.	7.30
180-239 days	7.30	Jan.	7.25
240-270 days	7.30		

‡Industrial Paper—Prime			
30- 89 days	7.36%	†Federal Funds Effective Rate	8.00%
90-120 days	7.30		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'85	$ 3,811	$ 3,759	$ 3,553
Gross National Product (1972 Dollars)*	1st Q'85	$ 1,664	$ 1,662	$ 1,611
Percent Change, Annual Rate	1st Q'85	0.3	4.3	10.1
Change in Consumer Prices*	May '85	2.4%	4.8%	2.4%
Change in Producer Prices*	May '85	2.4%	3.6%	– 1.2%
Civilian Employment (Thousands of Persons)†	Jun '85n	106,370	106,960r	105,391
Unemployment as % of Civilian Labor Force†	Jun '85n	7.3%	7.3%	7.2%
Personal Income*	May '85	$ 3,172	$ 3,189	$ 2,979
Leading Indicators Composite Index (1967=100)†	May '85n	167.8	166.6r	168.2
Industrial Production Index (1967=100) †	May '85	165.3	165.5	162.8
Net Change in Consumer Installment Credit †	Apr '85	$ 8.27	$ 8.34	$ 6.79
U.S. Merchandise Trade Balance †	May '85n	–$ 12.67	–$ 11.85	–$ 9.28
Plant and Equipment Expenditures*	3rd Q'85	$392.61(a)	$385.31(a)	$361.12
Private Housing Starts (Thousands of Units)*	May '85	1,663	1,927	1,787
New Construction Expenditures*	May '85n	$ 343.5	$ 338.3r	$ 315.7r
Total Business Inventories †	Apr '85	$ 581.3	$ 578.8	$ 545.9
Total Business Sales †	Apr '85	$ 425.7	$ 420.8	$ 408.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

Yet, business credit demands have been soft not only when compared with last year, but they have been unusually weak for this stage of the business cycle. As shown in the chart on page 1, net funds raised by nonfinancial corporations in the debt and equity markets in the first quarter of 1985 were equivalent to just 1½ percent of GNP—a level more often associated with the bottom of past recessions (the shaded areas in the chart), not the third year of business expansions.

Although the Fed must remain wary of the longer-term impact of the ballooning Federal deficit, and the apparent inability of the Administration and Congress to hammer out a credible deficit reduction program, while others have wondered how long the central bank will tolerate M1 money supply growth well above target, these concerns may not be the principal factors affecting the near-term stance of monetary policy. With economic growth rates still sluggish, inflation rates modest, the broader money supply aggregates within target and business credit demands weak, there are few good reasons not to tilt toward further monetary policy ease. If, as a by-product of these initiatives the dollar moves lower in the foreign exchange markets, then the road to recovery for the hard-pressed manufacturing sector will become clearer as well.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (6/19/85)	155,603	+ 201	+ 781
New York City (6/19/85)	32,694	– 316	– 1,424
Commercial Paper (6/19/85)	260,136	+ 63	+40,054

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/19/85)	253,748	+ 535	+ 8,435
New York City (6/19/85)	61,491	+ 214	– 2,941

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/19/85)	682,809	+ 5,079	+ 65,257
New York City (6/19/85)	154,469	+ 3,351	+ 15,663

Financial Markets

	Friday 7/5/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.99%	– .06	– 3.41
180-Day Bills†	7.12	– .18	– 4.03
Longest Bills†	7.37	– .33	– 4.68
Recent Issues:			
8½s 6/30/87	8.34	– .31	
9⅝s 6/30/89	9.06	– .39	
11¼s 5/15/95	9.91	– .34	
11¼s 2/15/15	10.21	– .28	
Municipals:			
Bond Buyer–20 Bond Index* (7/3/85)	8.82%	+ .02	– 1.87
Blue List Total ($ Million)	$1,903	– $277	+ $ 467
30-Day Visible Supply ($ Million)	$3,745	+ $280	+ $1,744
Total	$5,648	+ $ 3	+ $2,211
Corporates:			
Moody's Aa Composite (7/2/85)	11.46%	– .06	– 3.01
30-Day Visible Supply ($ Million)	$1,798	+ $685	+ $1,201
Stocks:			
Dow-Jones Averages:			
Industrials	1,335.69	+ .23	+ 213.12
Transportation	678.25	+ 14.16	+ 203.56
Utilities	166.34	+ 1.49	+ 40.67
65 Stocks	555.40	+ 4.03	+ 117.52
Standard and Poor's 500 Stocks (7/3/85)	191.45	+ .40	+ 37.75
N.Y.S.E. Composite Index	111.64	+ .53	+ 23.74
N.Y.S.E. Avg. Daily Vol. for Week (000's)	89,590	–13,970	+ 21,720

* 46% Taxable equivalent 16.33%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/5/85	Week Ago
Overnight	7.88%	7.88%
1 month	7.63	7.63
3 month	7.69	7.75
6 month	7.75	8.00
1 year	8.06	8.31
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	10.09%	10.17%
Long Term (7 to 15 yrs.)	10.57	10.65

FOREIGN EXCHANGE SPOT RATES

New York Opening (7/5/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01636	61.1100
Canada	.7362	1.3584
Denmark	.08184	10.8880
France	.1083	9.2345
Germany	.3296	3.0340
Italy	.0005164	1936.50
Japan	.004036	247.80
Mexico	.003150	317.50
Netherlands	.2925	3.4183
Switzerland	.3933	2.5425
U.K.	1.3175	.7590

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